

D. T. E. 00-40

Application of Western Massachusetts Electric Company, an Electric Company under G.L. c. 164, § 1, for Approval of Rate Reduction Bonds Under the Terms of the Electric Restructuring Act, St. 1997, c. 164.

APPEARANCES: Stephen Klionsky, Esq.

260 Franklin Street, 21st Floor

Boston, Massachusetts 02110

and

Jay E. Gruber, Esq.

Palmer & Dodge

One Beacon Street

Boston, Massachusetts 02108

FOR: WESTERN MASSACHUSETTS ELECTRIC COMPANY

Petitioners

Thomas J. Reilly, Attorney General

BY: Joseph W. Rogers

Assistant Attorney General

Regulated Industries Division

200 Portland Street, 4th Floor

Boston, Massachusetts 02114

Intervenor

Maria Krokidas, Esq.

Krokidas & Bluestein

141 Tremont Street

Boston, Massachusetts 02111-1209

FOR: MASSACHUSETTS DEVELOPMENT FINANCE AGENCY
Page 1

and

FOR: MASSACHUSETTS HEALTH & EDUCATIONAL FACILITIES AUTHORITY

Intervenors

Andrew J. Newman, Esq.

Rubin & Rudman LLP

50 Rowes Wharf

Boston, Massachusetts 02110-3319

FOR: WESTERN MASSACHUSETTS INDUSTRIAL

CUSTOMERS GROUP

Intervenor

Scott J. Mueller, Esq.

LeBoeuf, Lamb, Greene & MacRae, LLP

260 Franklin Street

Boston, Massachusetts 02110

FOR: FITCHBURG GAS AND ELECTRIC

LIGHT COMPANY

Limited Participant

Mary Beth Gentleman, Esq.

Wayne Barnett, Esq.

Foley, Hoag & Eliot LLP

One Post Office Square

Boston, Massachusetts 02109-2170

FOR: MASSPOWER

Limited Participant

TABLE OF CONTENTS

I. INTRODUCTION	1
II. STANDARD OF REVIEW	3
III. WMECO'S SECURITIZATION PROPOSAL	6
A. Introduction	6
B. Mitigation of Transition Costs	11
1. Introduction	11
2. Analysis and Findings	12
C. Savings to Ratepayers	13
1. Introduction	13
2. Analysis and Findings	14
D. Employee Commitments	15
E. Order of Preference for Use of Proceeds	16
IV. AMOUNTS TO BE SECURITIZED	17
V. PROPOSED FINANCING ORDER	20
A. Adjustments to the RTC Charge	20
1. Introduction	20
2. Positions of the Parties	21
a. Agencies	21
b. WMECo	22
3. Analysis and Findings	23
B. Working Capital Account Related to the RTC	24
1. Introduction	24
2. Analysis and Findings	26
VI. ORDER	27
VII. APPENDIX	30

I. INTRODUCTION

On April 18, 2000, Western Massachusetts Electric Company ("WMECo" or "Company") filed an application for approval of rate reduction bonds ("RRBs") pursuant to G.L. c. 164, § 1H(b). WMECo initially proposed to securitize approximately \$261 million of transition costs. (1) The majority of these transition costs are associated with the Company's unrecovered Millstone 2 and Millstone 3 plant balances and the buydown payment of the Springfield Resource Recovery Facility ("Springfield") Power Purchase Agreement ("PPA") and the MASSPOWER buyout payment. The application was docketed as D.T.E. 00-40.

Pursuant to notice duly issued, public hearings were held at the Department's offices in Boston on May 26, 2000, and in the Company's service territory in Amherst, Massachusetts, on May 30, 2000. The Attorney General of the Commonwealth ("Attorney General") filed a notice of intervention pursuant to G.L. c. 12, § 11E. The Department allowed the petitions to intervene of the Massachusetts Development Finance Agency and Massachusetts Health and Educational Facilities Authority (collectively, the "Agencies"), and the Western Massachusetts Industrial Customers' Group ("WMICG"). Fitchburg Gas and Electric Light Company ("Fitchburg") and MASSPOWER were allowed to intervene as limited participants. In its notice, the Department requested comments on WMECo's petition. The Agencies filed comments with the Department on May 30, 2000.

Evidentiary hearings were held on June 20 and 21, 2000. In support of its petition, WMECo presented the testimony of Richard Soderman, the director of regulatory policy and planning for Northeast Utilities Service Company; Randy Shoop, the assistant treasurer of finance for Northeast Utilities ("NU"), and Mark Englander, the senior financial analyst in the finance group of NU. Briefs and reply briefs were filed by WMECo, the Agencies, WMICG, and the Attorney General.

On August 1, 2000, the Department, on its own motion, reopened the evidentiary hearings to admit additional evidence regarding the pending sale of the Millstone nuclear units. In supplemental responses to record requests filed on August 11, 2000, WMECo amended its filing to reduce to \$161.9 million the principal amount proposed to be securitized as a result of the terms upon which the Millstone nuclear units were to be sold. On September 6, 2000, the Agencies filed comments regarding the Company's amended filing.

On December 22, 2000, WMECo and the Attorney General filed an offer of settlement ("Settlement") with the Department. (2) The Settlement, if accepted by the Department, authorizes WMECo to issue approximately \$155 million of RRBs, contingent upon customer savings and subject to a revised draft financing order (Settlement at 3). On January 3, 2001, both the Agencies and WMICG commented on the Settlement ("Comments"). On January 10, 2001, WMECo submitted a revised proposed financing order (Exh. WM-1R) for issuance by the Department as an Appendix to this Order. The Department requested supplemental comments on the revised proposed financing order. The Agencies filed supplemental comments with the Department on January 16, 2001 ("Supplemental Comments").

II. STANDARD OF REVIEW

The Legislature has vested broad authority in the Department to regulate the ownership and operation of electric utilities in the Commonwealth. See, e.g., G.L. c. 164, § 76. The Department's authority was most recently amended by the Acts of 1997, c. 164 (the "Restructuring Act" or "Act"). (3) Western Massachusetts Electric Company, D.T.E. 97-120, at 10 (1999). The Act authorizes the Department to issue a financing order allowing a company to securitize its reimbursable transition costs amounts (both debt and equity) through

the issuance of electric RRBs. (4)

Untitled

A financing order may be issued by the Department to facilitate the provision, recovery, financing or refinancing of transition costs. G.L. c. 164,

§ 1H(b)(1).

Prior to issuing a financing order, the Department must have approved an electric company's restructuring plan. G.L. c. 164, § 1(A)(a). The restructuring plan must include, among other things, a company's strategy to mitigate the transition costs it seeks to recover through a non-bypassable transition charge. In order to issue a financing order, the Department must find that a company has demonstrated that the issuance of electric RRBs to refinance reimbursable transition costs will reduce the rates that a company's customers would have paid without the issuance of electric RRBs, and that the reduction in rates to customers equals the savings obtained by the company. G.L. c. 164, § 1(H)(b)(2). The company must establish, and the Department must approve, an order of preference for use of bond proceeds such that transition costs having the greatest impact on customer rates will be the first to be reduced by those proceeds. G.L. c. 164, § 1G(d)(4).

In order to approve an application for a financing order, the Department must also be satisfied that a company has (1) fully mitigated the related transition costs (including, but not limited to, as applicable, divestiture of its non-nuclear generation assets, (5)

renegotiation of existing power purchase contracts, and the valuation of assets of the company); and

(2) obtained written commitments that purchasers of divested assets will offer employment to any affected non-managerial employees who were employed at any time during the

three-month period prior to the divestiture, at levels of wages and overall compensation no lower than the employees' prior levels. (6)

G.L. c. 164, § 1G(d)(4).

III. WMECO'S SECURITIZATION PROPOSAL

A. Introduction

Securitization is a method for a company to refinance transition costs. The Act authorizes an electric company to securitize its transition costs by issuing RRBs to investors that will be repaid through a portion of the transition charge. G.L. c. 164, § 1H. If assigned a high credit rating, (7)

the RRBs will have an interest rate lower than the carrying charge paid by ratepayers as part of the transition charge, thereby generating savings to ratepayers. (8)

Per the Settlement, which proposes amendment of WMECo's April 18, 2000 application, the Company seeks to securitize \$155 million of transition costs (and related costs of issuance) by issuing RRBs (Settlement at 3). The proposed estimated principal amount of the RRBs comprises: (1) the unrecovered Millstone 2 and Millstone 3 plant balances incurred as of December 31, 1995, approved as transition costs in D.T.E. 97-120; (2) the buydown payment and any related transaction costs of the Springfield PPA, approved as transition costs in Western Massachusetts Electric Company, D.T.E. 99-56 (1999), and the MASSPOWER PPA, approved as transition costs in Western Massachusetts Electric Company,

D.T.E. 99-101 (2000); (3) the Department of Energy decontamination and decommissioning ("DOE - D&D") costs approved as a transition cost in D.T.E. 97-120; (4) the non-Millstone 3 net of tax debt allowance for funds used for construction approved as a transition cost in D.T.E. 97-120; and (5) the unamortized loss on

Untitled

required debt, refinancing expenses, call or tender premiums and transaction costs (Exh. WM-1R at 6-7)). (9)

After the Act took effect, the Department, the Agencies, the Massachusetts-based electric companies and other interested parties, such as investment bankers and statistical rating organizations ("rating organizations"), developed a structure for a RRB transaction (Exh. WM-8 at 2). As part of its application, WMECo submitted a proposed financing order that was prepared in consultation with the Agencies and that is based on the previous Massachusetts RRB issuance by Boston Edison Company ("BECo") (Exh. WM-6, at 4).

WMECo seeks to recover a portion of its transition costs through the RRBs, together with the transaction costs of issuing RRBs, ongoing transaction costs, and the costs of providing credit enhancements. WMECo also seeks an exemption from the competitive bidding requirements of G.L. c. 164, § 15, in connection with the sale of the RRBs, and from the par value debt issuance requirements of G.L. c. 164, § 15A. (10)

If approved by the Department, the amounts WMECo seeks to recover will constitute reimbursable transition cost ("RTC") amounts and will be financed through the issuance of RRBs. A portion of WMECo's transition charge, the RTC charge, will be used to repay these amounts. The RRBs will be backed by collateral, including the right to all collections or proceeds arising from (1) recoverable transition costs, (2) the RTC charge, and (3) adjustments to the RTC charge (collectively, the "Transition Property") as set forth in the revised financing order (Exh. WM-1R at 3).

WMECo will sell the Transition Property to a special purpose entity ("SPE") (id. at 4). The SPE will be a bankruptcy-remote entity owned and initially capitalized by WMECo (id.). To raise the funds to buy the Transition Property from WMECo, the SPE will issue and sell SPE debt securities to a special purpose trust established by the Agencies (id.). This special purpose trust will then issue RRBs, the proceeds of which will be remitted to the SPE and ultimately to WMECo (id.). Once a financing order is issued, neither the Department nor the Commonwealth of Massachusetts (pursuant to G.L. c. 164, § 1H(b)(3)) can alter or revoke the transfer of Transition Property or the RTC Charges.

In order to maximize the savings obtainable from securitization, the RRBs must achieve the highest possible rating. The RRBs will receive ratings from national rating organizations. The rating of debt instruments backed by regulatory assets such as the RRBs is not tied to the rating of the distribution company; instead, it is based on an analysis of the underlying collateral and the specific transaction structure. A credit rating analysis takes into account elements that are customary in an asset securitization and combines them with a detailed analysis of the regulatory and legal foundation of the asset account and the collection mechanisms. Rating organizations will consider the following characteristics of RRBs:

(1) bankruptcy-remoteness of the seller, (2) predictability and nonbypassability of the RTC charge, (3) standards governing a third party supplier ("TPS"), (4) credit enhancement,

(5) the assurance of irrevocability by the Commonwealth of Massachusetts; and (6) other statutory safeguards (id. at 1-5).

The Act establishes the Agencies as a financing entity for RRBs. G.L. c. 164,

§ 1H(a). In this capacity, the goal of the Agencies is to protect the interests of WMECo's ratepayers by (1) ensuring the lowest all-in cost pricing reasonably obtainable for RRBs, (11)

(2) streamlining the administrative processes thereby minimizing the costs of issuing the RRBs, and (3) providing consulting services to the Department. G.L. c. 164, § 1H(b)(2). The Agencies have a number of other responsibilities under the Act, including, but not limited to, the issuance of the RRBs. The Agencies will approve

Untitled

the terms and conditions of the RRBs, including structure, pricing, credit enhancement, relevant issuance costs and manner of sale. In addition, in order to minimize the all-in costs of the RRBs and associated administrative expenses, the Agencies will coordinate with WMECo regarding the marketing of the RRBs, the procurement of bond trustees and related services, and the selection of rating organizations and the underwriting syndicate (Exh. WM-8, at 1-2).

The Act requires the Department to find that specific conditions have been met in order for a company to be eligible to issue electric RRBs. Consistent with the standard of review, the Department's analysis of WMECo's proposed securitization transaction will focus on (1) the mitigation of transition costs, (2) the savings to ratepayers, (3) the employee commitments, and (4) the order of preference for use of proceeds.

B. Mitigation of Transition Costs

Introduction

The Act requires a company to have an approved restructuring plan that establishes its overall mitigation strategy and to divest its non-nuclear assets in order to be able to securitize its reimbursable transition costs. G.L. c. 164, §§ 1A(a), 1(G)(d)(3). WMECo filed a restructuring plan with the Department on December 31, 1997 that included a detailed accounting of WMECo's transition costs and mitigation strategy. On February 20, 1998, the Department, subject to further review and reconciliation, approved WMECo's restructuring plan on a preliminary basis. On September 19, 1999, the Department approved the mitigation strategy proposed in its restructuring plan filing and authorized WMECo to recover its associated transition costs (Exh. WM-2, at 4, citing Western Massachusetts Electric Company, D.T.E. 97-120 (1999)).

Pursuant to its restructuring plan, WMECo has in place a nuclear performance-based ratemaking ("PBR") plan related to Millstone 2 and Millstone 3 (id. at 7). This PBR mechanism provides an offset to the stranded costs associated with these units until divestiture (id.). In Western Massachusetts Electric Company, D.T.E. 99-29 (1999), and in Western Massachusetts Electric Company, D.T.E. 99-74 (1999), the Department approved the divestiture of WMECo's non-nuclear generating assets. In Western Massachusetts Electric Company, D.T.E. 00-68 (2000), the Department approved the divestiture of WMECo's nuclear generating assets. With respect to its PPAs, the Company received approval of the buyout of the Springfield PPA and the MASSPOWER PPA. Western Massachusetts Electric Company, D.T.E. 99-56 (1999); Western Massachusetts Electric Company, D.T.E. 99-101. The Department is currently considering the buyout of the Vermont Yankee PPA in

D.T.E. 00-11 (Exh. WM-2, at 5). (12)

2. Analysis and Findings

An electric company seeking to recover transition costs is required to mitigate such costs. G.L. c. 164, § 1G(d)(1). Prior to approving the recovery of transition costs through the transition charge, the Department must find that a company has taken "all reasonable steps to mitigate to the maximum extent possible the total amount of transition costs that will be recovered" from ratepayers. G.L. c. 164, § 1G(d)(1). The Department approved the recovery of transition costs through WMECo's transition charge in (1) the restructuring plan approved by the Department in D.T.E. 97-120, including approval of the nuclear asset divestiture plan and a PBR mechanism, (2) the approval of the non-nuclear asset divestitures in D.T.E. 99-29 and D.T.E. 99-74, (3) the approval of the nuclear asset divestiture in D.T.E. 00-68, and (4) the approval of the renegotiations of PPAs in D.T.E. 99-56 and D.T.E.

99-101. In each case, the Department found that WMECo had taken all reasonable steps to mitigate, to the maximum extent possible, such transition costs. G.L. c. 164, § 1G(d)(1). Accordingly, the Department finds that WMECo has met its obligation to mitigate the transition costs it seeks to securitize for the purposes of G.L. c. 164, § 1G(d)(4)(i).

C. Savings to Ratepayers

1. Introduction

Under the Company's restructuring plan, ratepayers pay a carrying charge of 12.63 percent for all unrecovered transition costs (Exh. WM-2, at 25). WMECo argues that its ratepayers will benefit from securitization if the carrying cost of the RRBs plus transaction costs and call premiums is less than its current 12.63 percent carrying charge (id. at 24). Based on the current bond market conditions, WMECo forecasts that the carrying charge rate of 12.63 percent will be reduced to approximately 7.97 percent for the securitized transition costs (Exh. DTE-5-2, exh. RAS-2, at 13). WMECo calculates the total net present value of savings to its ratepayers as a result of securitization to be approximately \$32 million based on its estimates of the carrying cost of the RRBs, the amount to be securitized, the tax benefit associated with the PPA buyouts, and the discount rate (Exh. DTE-5-2). The Company calculated the estimated savings by comparing its transition costs under two scenarios:

(1) no securitization of transition costs with traditional carrying costs applied; and

(2) a securitization that assumes, as of the December 22, 2000 filing, that \$155 million is funded with RRBs (Exh. DTE-5-2, exhs. RAS-2, RAS-3).

Although no party disputed that securitization will yield ratepayer savings as long as the interest rate on the RRBs is less than 12.63 percent, WMICG states that the Settlement indicates that "substantial customers savings" will result from securitization (WMICG Comments at 1). WMICG argues that if the final calculation of the savings does not exceed a minimum level, such as \$10 million, the RRBs should not be issued (id.). The Agencies support approval of WMECo's request to securitize its transition costs stating that, in their capacity as the financing entity, their goal is to protect the interests of the Company's ratepayers by ensuring the lowest, all-in-cost, pricing reasonably obtainable for the RRBs (Agencies Brief at 2; Agencies Supplemental Comments at 2). The Agencies state that, in approving final terms and conditions of the RRBs, they will seek to avoid unnecessary or excessive costs in order to obtain maximum ratepayer savings, while at the same time obtaining the highest possible bond ratings (Agencies Brief at 3). The Agencies further state that approval of the Settlement will result in savings to ratepayers that are not otherwise available (Agencies Supplemental Comments at 2).

2. Analysis and Findings

In order to approve a financing order, the Department must find that savings to ratepayers will result from securitization and that all such savings derived from securitization will inure to the benefit of ratepayers. G.L. c. 164, §§ 1G(d)(4)(ii)-(iii). Neither WMECo nor the Agencies, as the financing entity, will authorize a bond issuance unless there are demonstrated ratepayer savings (Settlement at 3, Agencies Brief at 2-3). WMECo states that it will not issue RRBs unless the all-in cost of issuance of the RRBs results in a carrying charge of less than the current carrying charge of 12.63 percent (Exh. WM-2, at 25). Because securitizing at an all-in cost less than 12.63 percent will result in ratepayers paying a transition charge that is lower than what they would have paid without securitization, the Department finds that savings to ratepayers will result from securitization. Therefore, WMECo should proceed with securitization and ensure that all such savings will inure to the benefit of ratepayers, in accordance with G.L. c. 164, §§ 1G(d)(4)(ii)-(iii).

While WMECo forecasts savings to ratepayers of approximately \$32 million, the Department notes that the actual amount of ratepayer savings is predicated on market conditions at the time of bond issuance. On issuance, a financing order is irrevocable and may not be altered by the Department. G.L. c. 164, § 1H(b)(3). While the Settlement specifies that the issuance of the RRBs is contingent on savings to

Untitled

customers, pursuant to the Act, the Department must rely on the Agencies, as the financing entity, to ensure that the maximum level of ratepayer savings is obtained. G.L. c. 164, §§ 1H(a), 1H(b)(2); Boston Edison Company, D.T.E. 98-118, at 16 (1999).

D. Employee Commitments

Prior to approving a financing order, the Department must be satisfied that WMECo has obtained a written commitment from the purchasers of its divested generation units that all non-managerial employees who were employed at any time during the three-month period prior to the divestiture, will be offered employment at levels of wages and overall compensation no lower than the employees' prior levels. G.L. c. 164, § 1G(d)(4)(iv). Such commitments were obtained from the purchasers of the Company's generation units prior to divestiture (Exh. WM-2, at 5; WMECo Brief at 6). The purchasers' commitment appear firm and unavoidable. Therefore, the Department finds that WMECo has satisfied the requirements of G.L. c. 164, § 1(g)(d)(4)(iv) relating to employee commitments.

E. Order of Preference for Use of Proceeds

Before the Department may approve a financing order, WMECo must show that it has established an order of preference that impacts its customer's rates most favorably.

G.L. c. 164, § 1G(d)(4)(v). The Company proposes to apply the RRB proceeds to: (1) the costs of issuing the RRBs; (2) the buyout of its Springfield and MASSPOWER PPAs;

(3) retiring common equity; (4) retiring all of the Company's preferred stock; and (5) retiring debt (Exhs. WM-1R at 19; WM-3, at 3, 11).

Equity is a more expensive form of capital than debt. However, WMECo cautions that the retirement of common equity, which is made up of both preferred and common stock, must be limited because it is beneficial to maintain an approximate 60 to 40 percent debt to equity ratio in order to achieve a solid, investment-grade capital structure (Exh. WM-3, at 6-7). Therefore, WMECo states that the use of RRB proceeds would first be used to retire its preferred stock, which is the most expensive form of capital (id. at 9, 10). Next,

WMECo will retire as much of its common stock as possible, while still maintaining the optimum debt to equity ratio of 60 to 40 percent. Finally, the Company will reduce its debt by retiring its first mortgage bonds and short term debt (id. at 11). The amount of each security retired will depend on market conditions (id.). The exact order of preference will be reexamined at the time of issuance and may be adjusted if interest rates have changed significantly (id.). As a result of these proposed changes to WMECo's capital structure, the Company argues that its weighted cost of capital will be reduced from 12.63 percent to 11.84 percent (Exh. DTE-5-2, exh. RAS-2, at 12).

The Company's proposed use of proceeds will benefit ratepayers through the change in the debt to equity ratio that will redefine the capital structure of the Company. Further, with the proposed use of proceeds, the Company anticipates that its overall credit rating will improve and, in turn, lower its borrowing costs, thereby resulting in interest expense savings

(Exh. WM-3, at 8). These interest expense savings will be passed on to WMECo's ratepayers through the securitization process (Exhs. WM-3, at 8; DTE 5-2, exhs. RAS 1, RAS 2, at 12). Therefore, the Department finds that WMECo's proposal satisfies the requirements of the Act relative to the order of preference for use of bond proceeds, and thus complies with

G. L. c. 164, § 1G(d)(4)(v).

IV. AMOUNTS TO BE SECURITIZED

WMECo proposes to securitize the following costs: (1) the unrecovered Millstone 2 and Millstone 3 plant balances incurred as of December 31, 1995, approved as transition costs in D.T.E. 97-120; (2) the buydown payment and any related transaction costs of the Springfield PPA, approved as transition costs in Western Massachusetts Electric Company, D.T.E. 99-56 (1999), and the MASSPOWER PPA, Western Massachusetts Electric Company, D.T.E. 99-101; (3) the DOE - D&D costs approved as a transition cost in D.T.E. 97-120;

(4) the non-Millstone 3 net of tax debt allowance for funds used for construction approved as a transition cost in D.T.E. 97-120; and (5) the unamortized loss on required debt, refinancing expenses, call or tender premiums and transaction costs (Exh. WM-1R at 6-7). Per the Settlement, the total amount the Company proposes to securitize is approximately \$155 million (Settlement at 3).

The Agencies have reviewed the Company's estimated transaction costs, including the costs of issuing, servicing, and retiring the RRBs, and the proposed administration and servicing fees, and have found the costs to be reasonable both in terms of the Company's proposed transaction and in comparison with the BECo RRB transaction (Agencies Brief at 8; Agencies Supplemental Comments at 1). The Agencies commit to review the final transaction costs at the time of issuance and to monitor the proposed recovery of transaction costs, including ongoing transaction costs included in the RTC charge (*id.*).

Because the bonds issued pursuant to this Order will be without recourse to the credit of WMECo or any assets of WMECo, and because the bonds will constitute irrevocable obligations levied until their retirement on bills paid by the ratepayers of WMECo, the Department must scrutinize all amounts proposed to be included in the securitization total to ensure that only those costs that have been shown to be recoverable and mitigated are securitized. The Attorney General and WMECo agree that the \$155 million to be securitized represents a reasonable estimate of WMECo's transition costs as defined in G.L. c. 164,

§ 1G (Settlement at 3-4). However, these parties acknowledge the transition costs may change as a result of the actual Millstone proceeds and the adjudication of issues in WMECo's reconciliation filing, D.T.E. 00-33 (*id.*). (13)

In D.T.E. 97-120, D.T.E. 99-56, and D.T.E. 99-101, the Department found that the costs the Company seeks to securitize are mitigated and approved transition costs. Therefore, consistent with our earlier findings in D.T.E. 97-120, D.T.E. 99-56, and D.T.E. 99-101, these costs are recoverable, and can be included in the transition costs to be securitized. In addition, because the Act permits recovery of refinancing costs as transition property, the Department will allow WMECo to securitize the refinancing costs associated with the securitization (e.g. the unamortized loss on required debt, refinancing expenses, call or tender premiums and transaction costs). See G.L. c. 164, § 1H(a). However, the Department will review the reasonableness of these costs in the Company's next transition charge reconciliation proceeding, and may, at that time, disallow the recovery of costs that are found to be unreasonable. The Department will ensure that any disallowance of the refinancing costs will not affect the RTC charge. Furthermore, if WMECo's actual refinancing costs are lower than the securitized amount, the Department directs WMECo to return to ratepayers any amounts in excess of its actual costs.

Based on the foregoing analysis and findings, the Department will allow WMECo to securitize approximately \$155 million of the following costs: (1) the unrecovered Millstone 2 and Millstone 3 plant balances incurred as of December 31, 1995, approved as transition costs in D.T.E. 97-120; (2) the buydown payment and any related transaction costs of the Springfield PPA, approved as a transition cost by the Department in D.T.E. 99-56, and the MASSPOWER PPA approved as transition costs in D.T.E. 99-101; (3) the DOE - D&D costs approved as a transition cost in D.T.E. 97-120; (4) the non-Millstone 3 net of tax debt allowance for funds used for construction approved as a transition cost in D.T.E. 97-120; and (5) the unamortized

Untitled

loss on required debt, refinancing expenses, call or tender premiums and transaction costs. Consistent with the terms of the Settlement, the Company is directed to refund any excess amounts securitized to ratepayers through a credit in an amount equal to the excess amount securitized including carrying costs.

V. PROPOSED FINANCING ORDER

As discussed above, WMECo, in consultation with the Agencies, submitted an initial proposed financing order with its petition and later a revised proposed financing order with the Settlement (Exh. WM-1R). The Department includes an attachment (Appendix 1) to this Order that incorporates the Department's findings herein. Appendix 1, which is part of the Department's financing order, contains additional terms for the issuance of the bonds. Appendix 1 also includes reporting forms (Appendix A, att. 1-4, and Appendix B) that shall be filed with the Department by the Agencies on bond issuance. In the following sections, the Department reviews and analyzes certain provisions in the proposed financing order:

(1) adjustments to the RTC charge; and (2) working capital account related to the RTC charge. Pursuant to such review, the Department approves the proposed financing order attached hereto as Appendix 1.

A. Adjustments to the RTC Charge

1. Introduction

WMECo proposes to adjust the RTC charge periodically to ensure that it remains sufficient to generate an amount equal to the sum of the periodic RRB payment requirements for the upcoming year, subject to a 3.35 cents per kilowatthour ("KWH") cap on the transition charge (Exhs. WM-1R at 14, WM-2, at 18). The initial RTC charge is estimated to be 0.523 cents per KWH for all classes of retail customers (Exh. DTE-5-2, exh. RAS-2, at 1-2). The Company performed a "stress case" analysis to determine the level of transition charge required to support the bonds in the event that an improbable set of events occurs that would jeopardize (1) the ongoing transaction costs, (2) the semi-annual interest payments, (3) the reduction of the principal balance, or (4) any other shortfall jeopardizing repayment of the RRBs (Exh. WM-2, at 17). Based on this stress analysis the Company established the 3.35 cents per KWH cap for the transition charge (Exh. WM-1R at 14).

Further, the proposed revised financing order specifies that if an adjustment to the transition charge to meet the rate reduction requirements of the Act would cause it to fall below the required RTC charge, then the Department shall instead allow WMECo to adjust other rate components so that the transition charge remains higher than the RTC charge.

(Exhs. WM-1R at 14, WM-2, at 19). In addition, the proposed revised financing order provides that, to the extent the RTC charge displaces recovery of other transition costs that are not funded with the RRBs, such other transition costs will be deferred with a return for future recovery (i.d.).

2. Positions of the Parties

a. Agencies

The Agencies argue that WMECo's proposal for periodic adjustments to the RTC charge are necessary to improve the creditworthiness of the bond issue which will insure the highest possible rating (Agencies Brief at 4). Further, the Agencies argue that deferral of other rate components at an appropriate carrying charge is necessary to ensure that the Company neither gains nor loses from such a deferral (Agencies Reply Brief at 2). The Agencies maintain that, if the Company's revenues are reduced to support the transition charge without the payment of an appropriate carrying charge, a link would be created between the Company and the SPE, which would be a barrier to receiving a true-sale and non-consolidation opinion from bankruptcy counsel (Agencies Brief at 3). (14)

Untitled

Finally, the Agencies maintain that the deferral provision is similar to what was approved by the Department in BECo's securitization (Agencies Reply Brief at 2, citing Boston Edison Company, D.T.E. 98-118A (1999)). In the BECo securitization, the Agencies argued that the deferral provision was deemed necessary and sufficient to permit bankruptcy counsel to issue a true-sale and non-consolidation opinion (Agencies Reply Brief at 2).

b. WMECo

The Company argues that changes in other rate components, other than the RTC, are not relevant to this proceeding because there are no net increases in the non-RTC components of the rates (WMECo Reply Brief, at 19). The Company further argues that while a decrease in the non-RTC components of the rates would create the need for deferrals, in the absence of securitization, WMECo would be entitled to collect its transition costs and, if the charge necessary to collect them were to increase, additional deferrals would be necessary (*id.*). If the required RTC charge exceeds the level of the transition charge, then other rate components would need to be reduced and deferred for future recovery at the carrying charge applicable to that rate (Tr. 1 at 85-86; Exh. WM-2, at 20-21).

3. Analysis and Findings

In Western Massachusetts Electric Company, D.T.E. 00-110, the Department approved a 2001 transition charge of 0.535 cents per KWH. Under the terms of the proposed Settlement, approximately 97 percent of this transition charge will be required to support the payments on the RRBs. WMECo maintains that the size of the charge supporting the RRB relative to the size of the transition charge does not directly affect the rating of the bonds (Exhs. DTE-6-2, DTE-7-2). Nonetheless, this small level of "headroom" could be an issue if a reduction in sales causes a shortfall in revenues to support the RRB payments.

In the event there are insufficient transition charge revenues to support the RRB payments, the amended financing order requires adjustment to other components of WMECo's rates (Exh. WM-1R at 14). In its Restructuring Order, D.T.E. 97-120, the Department instructed WMECo to charge the wholesale price for standard offer service. D.T.E. 97-120, at 190. Therefore, a standard offer deferral mechanism is not automatic and requires the Company to request approval for any standard offer deferrals. D.T.E. 97-120, at 191. Thus, while it may be possible for the Company to adjust its standard offer rate, this request should be made as a final resort after other options are considered. In the event rate components need to be lowered and deferred to accommodate a higher transition charge, such adjustments will have to be approved by the Department within the true-up procedure proposed by the Company and the Agencies (Exhs. WM-4, at 22, WM-1R at 14; Agencies Brief, at 5). The Department finds that the proposed true-up and review procedures for the RTC and other rate components permit sufficient opportunity for Departmental oversight.

Furthermore, the Department recognizes that the RTC charge adjustment mechanism is necessary for the proposed securitization. The rating organizations will expect the RTC charge to be sufficient to cover the expected amortization of the principal amount and interest of the RRBs, together with fees and expenses. If the RTC charge initially established is not sufficient to cover these payments, the rating organizations will expect to see a true-up mechanism that would adjust the RTC charge on a timely basis. Therefore, the Department finds that such a true-up mechanism is necessary to ensure that the RTC charge is sufficient to cover the expected amortization of the principal amount and interest of the RRBs, together with fees and expenses, and to protect the credit-worthiness of the RRBs, the linchpin of this effort.

B. Working Capital Account Related to the RTC

1. Introduction

Untitled

WMECo states that the Agencies will require an amount of cash to be set aside and remitted to the SPE, sufficient to ensure that the RRB payments will be made (Exh. DTE-1-3). WMECo proposed to contribute approximately \$720,000 to a working capital account to cover the 45-day lag between the date when bondholders receive their payment and the date when the SPE receives the RTC funds, which helps ensure adequate RRB payments (Exh. WM-2,

at 15-16, DTE-5-2, exh. RAS-2, at 2; WMECo Reply Brief at 16). This lag is caused by the delay between when the Company provides service and when it receives payment from its ratepayers (id.). To compensate for the use of its capital, WMECo proposed to apply a carrying charge at its cost of capital (12.63 percent) on the working capital account (id. at 16). If approved, the carrying charge for this capital advance will amount to approximately \$89,000 annually to be collected as an adder to the RTC charge (Exhs. WM-2, at 14, exh. RAS-6; DTE-5-2, exh. RAS 2, at 2).

WMECo argues that the allowance for costs as part of its distribution rates compensates WMECo for costs presented in its last rate case, which predates its securitization application (WMECo Reply Brief at 16). WMECo maintains that because the funding of the working capital account is an expense associated with servicing the RRBs and is required as a credit enhancement by the Agencies, it is, therefore, entitled to compensation (Exh. DTE-1-3; WMECo Reply Brief at 16-17).

The Attorney General initially contested the collection of a carrying charge on the Company's working capital account, arguing that this amount may already be included in distribution rates (Attorney General Brief at 6, citing RR-AG-8). However, the schedules submitted by the Company pursuant to the Settlement show the inclusion of a carrying charge on the working capital account (Exh. DTE-5-2, exh. RAS-2, at 2).

2. Analysis and Findings

Working capital is a cost incurred to support the RRB payments and, according to the Agencies, it provides additional assurance that bondholders will receive payment. Creation of a separate account is required by the Agencies as an additional means of credit enhancement to ensure that the RRBs receive the highest possible credit rating. To create this account, the Company is investing its own funds for a statutorily required and beneficial regulatory purpose. The Restructuring Act requires all savings associated with securitization to be passed on to ratepayers. G.L. c. 164, § 1(H)(b)(2). Therefore, it is reasonable to permit the Company to collect its working capital costs associated with providing these savings. While we recognize that the Company already has a working capital component as part of its distribution rates, the working capital associated with the RRBs is a new cost. The working capital component included in the Company's distribution rates predates this proceeding, and the costs associated with securitization were not known at the time of the Company's last rate case. See *Western Massachusetts Electric Company*, D.P.U. 91-290 (1992). Accordingly, the Department will allow the Company to collect a carrying charge at its cost of capital on its working capital account through the RTC charge as specified in Exhibit DTE-5-2, exhibit RAS-2, at 2. (15)

As the Agencies are charged with ensuring the lowest all-in cost possible for the RRBs, the Department will rely on them to reassess the need for a working capital account as an additional credit enhancement at the time of the RRB issuance (see Exh. WM-8, at 1). In addition, in order to assure an accurate level of working capital, the Company is directed to submit, at the time of its transition charge reconciliation filings, an appropriate a lead-lag study.

VI. ORDER

Accordingly, after due notice, hearing and consideration, it is hereby

ORDERED: That Western Massachusetts Electric Company's April 18, 2000 application,

Untitled

as later modified by the December 22, 2000 Settlement, is APPROVED and the issuance of rate reduction bonds by Western Massachusetts Electric Company to securitize reimbursable transition costs amounts pursuant to this Financing Order and Appendix 1, which contains additional terms for the issuance of bonds, is hereby approved; and it is

FURTHER ORDERED: That the amount which Western Massachusetts Electric Company may securitize comprises the costs associated with (1) the unrecovered Millstone 2 and Millstone 3 plant balances incurred as of December 31, 1995, approved as transition costs in D.T.E. 97-120; (2) the buydown payment and any related transaction costs of the Springfield PPA, approved as a transition cost by the Department in D.T.E. 99-56, and the MASSPOWER PPA approved as transition costs in D.T.E. 99-101; (3) the DOE - D&D costs approved as a transition cost in D.T.E. 97-120; (4) the non-Millstone 3 net of tax debt allowance for funds used for construction approved as a transition cost in D.T.E. 97-120; and (5) the unamortized loss on required debt, refinancing expenses, call or tender premiums and transaction costs; and it is

FURTHER ORDERED: That Western Massachusetts Electric Company comply with all other orders and directives contained herein.

By Order of the Department,

James Connel ly, Chai rman

W. Robert Keati ng, Commi ssi oner

Paul B. Vasi ngton, Commi ssi oner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition is filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sed. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

1. This amount has been reduced to \$155 million pursuant to a joint offer of settlement submitted by WMECo and the Attorney General of the Commonwealth of Massachusetts on December 22, 2000.

2. A settlement, in effect, requests modification of an originally filed (and perhaps already adjudicated) application or petition. See Massachusetts Electric Company/Eastern Electric Company, D.T.E. 99-47, at 20 (2000).

3. An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provisions of Electricity and Other Services, and Promoting Enhanced Consumer Protections Therein, signed by the Governor on November 25, 1997. St. 1997, c. 164.

Untitled

4. 4 "Electric rate reduction bonds" are defined as, "bonds, notes, certificates of participation or beneficial interest, or other evidences of indebtedness or ownership, issued pursuant to an executed indenture, financing document, or other agreement of the financing entity, secured by or payable from transition property, the proceeds of which are used to provide, recover, finance or refinance transition costs or to acquire transition property and that are secured by or payable from transition property." G.L. c. 164, § 1(H)(a).

"Financing order" is defined as, "an order of the Department. . . approving a plan, which shall include, without limitation, a procedure to review and approve periodic adjustments to transition charges to include recovery of principal and interest and the costs of issuing, servicing, and retiring electric rate reduction bonds contemplated by the financing order." G.L. c. 164, § 1(H)(a).

"Reimbursable transition costs amounts" are defined as, "the total amount authorized by the Department in a financing order to be collected through the transition charge, as defined pursuant to G.L. c. 164, § 1, and allocated to an electric company in accordance with a financing order." G.L. c. 164, § 1(H)(a).

"Securitization" is defined as, the use of rate reduction bonds to refinance debt and equity associated with transition costs pursuant to G.L. c. 164, § 1H.

"Transition costs" are defined as, "the costs determined pursuant to G.L. c. 164, § 1G which remain after accounting for maximum possible mitigation, subject to determination by the Department." G.L. c. 164, § 1(H)(a).

"Transition charge" is defined as, "the charge to the customers which provides the mechanism for the recovery of an electric company's transition costs." G.L. c. 164, § 1(H)(a).

"Transition property" is defined as, "the property right created pursuant to this section, including, without limitation, the right, title and interest of an electric company or a financing entity to all revenues, collections, claims, payments, money, or proceeds of or arising from or constituting reimbursable transition costs amounts which are the subject of a financing order, including those non-bypassable rates and

Untitled

other charges that are authorized by the department in the financing order to recover transition costs and the costs of providing, recovering, financing, or refinancing the transition costs, including the costs of issuing, servicing and retiring electric rate reduction bonds." G.L. c. 164, § 1(H)(a).

5. The Act prescribes that a company that fails to divest its non-nuclear generation assets is not eligible to benefit from securitization and the issuance of electric RRBs. G.L. c. 164, § 1(G)(d)(3). However, the Act also provides that an electric company that has not divested its non-nuclear generation facilities may be able to securitize its transition costs if it is not able to meet the 15 percent rate reduction required by the Act. G.L. c. 164, § 1(G)(c)(2).

6. In addition, the Department cannot approve a company's application for securitization if the company owns, in whole or in part as of July 1, 1997, a nuclear-powered generation facility located in the Commonwealth that exceeds 250 megawatts in size, unless the company has executed a tax agreement with the plant's host community. G.L. c. 59, § 38H(c). WMECo does not own such a facility.

7. The rating of a bond is determined by quantifying this risk associated with the likelihood of timely payment of interest and ultimate repayment of principal by the final legal maturity date. Credit enhancements reinforce the likelihood that payments on the SPE debt securities will be made in accordance with the expected amortization schedule. Credit enhancements can include true-up adjustments, overcollateralization, capital accounts (equity contribution), and reserve accounts, additional reserve accounts, sureties, guarantees, letters of credit, liquidity reserves, repurchase obligations, cash collateral accounts, third party supports, or other similar arrangements.

8. WMECo's retail customers presently pay a carrying charge of 12.63 percent for all unrecovered transition costs (Exh. WM-2, at 24).

9. The dollar amounts associated with each category have been protected from public disclosure pursuant to G.L. c. 25, §5D (Tr. 1, at 5-6).

10. These two issues are addressed in the Appendix to this Order.

11. The all-in cost of the RRBs is the effective interest rate that includes the stated interest rate of the RRBs, i.e., the interest rate paid to investors, and the transaction costs of the securitization (Exhs. DTE-5-1, DTE-5-2).

12. WMECo is not seeking to securitize the amounts associated with the buyout of the Vermont Yankee PPA because the Company expects the RRBs to be issued prior to the Vermont Yankee transaction (Tr. 2, at 203; Exh. WM-2, at 5). At the request of the petitioner, the Department's investigation of D.T.E. 00-11 has been stayed pending resolution of the sale of Vermont Yankee. At the time of the petitioner's request, the Department was poised to issue its Order, but stayed its hand and will continue to do so at least for the interim. The petitioner is advised to bring D.T.E. 00-11 to a conclusion. It is time to wind up WMECo's restructuring cases filed to date.

13. Pursuant to the terms of the Settlement, if WMECo's actual transition costs are less than the amount securitized, then WMECo will provide its retail customers with a uniform cents per kilowatt hour rate credit in an amount equal to the excess amount securitized including carrying costs (Settlement at 4).

14. In "true-sale" and "non-consolidation" opinions, bankruptcy counsel opines that the transfer of the transition property from the Company, as seller, to the note issuer is an absolute sale and the assets and liabilities of the note issuer would not be substantially consolidated with those of the Company in the event of a future bankruptcy (Agencies Reply Brief at 2, n.1). The Agencies contend that the sale of the property right by WMECo to a bankruptcy-remote SPE must be treated as a true sale (id. at 2-3). A true sale is the transfer of transition property and not a secured borrowing (id.). A true sale designation prevents the assets from becoming part of any bankruptcy of WMECo. It is this feature that permits the RRBs to be

assigned a high credit rating (id. at 1-2).
Untitled

15. The Department notes that schedules attached to a settlement carry no precedential weight. See Barnstable Water Company, D.P.U. 91-189, at 6, n.3 (1992); Dover Water Company, D.P.U. 90-86, at 4 (1990).